SUPREME COURT, U. S.

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No. 527

IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

UNITED FUEL GAS COMPANY,
Appellant,

—against—

PUBLIC SERVICE COMMISSION OF WEST VIRGINIA,
Appellee.

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF THE STATE OF WEST VIRGINIA

MOTION TO DISMISS OR AFFIRM

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January 15, 1964.

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Comes now appellee and hereby moves the Court to dismiss the appeal herein or affirm the decision and judgment of the Supreme Court of Appeals of the State of West Virginia, from which decision and judgment said appeal was taken.

I. Brief Statement of Facts

United Fuel Gas Company is a West Virginia public utility with its main office and most of its facilities in the state of West Virginia. It has been engaged in the gas business in West Virginia for sixty years and

its West Virginia intrastate operations have been subject to the jurisdiction of the Public Service Commission of West Virginia for fifty years. Until after World War II, United Fuel produced or purchased its gas in West Virginia and Kentucky for markets in West Virginia and surrounding states.

After World War II a tremendous increase in the demand for gas, mostly in the company's interstate markets, and a decline in the production of Appalachian gas made it necessary for United Fuel to seek new gas supplies in the Southwest. In addition to other sources, it contracted to purchase large quantities of gas in Louisiana and contracted with Gulf Interstate Transmission Company (now Columbia Gulf, an affiliate) to transport that gas to United Fuel's facilities in West Virginia. In return for the transportation of the gas, United Fuel pays the cost of service of Columbia Gulf. This Louisiana gas, together with other Southwest gas, now constitutes more than 80 per cent of the gas supply of United Fuel Gas Company. During peak periods this Louisiana gas is sent directly to market. During summer periods it is delivered to various underground storage fields in West Virginia for withdrawal to meet the higher winter demand.

Although United Fuel now gets more than 80 per cent of its gas from the Southwest, it is still true that it purchases and produces more gas in West Virginia than it sells to West Virginia customers. United Fuel says, "Eighty per cent of the gas consumed by West Virginia customers originates in the Southwest" (Jurisdictional Statement, page 5), but it would be more accurate to say that the West Virginia customer

is charged as though 80 per cent of the gas came from the Southwest.

The truth is that nobody knows how much of the gas consumed in West Virginia is produced in West Virginia and how much comes from the Southwest. We do know that some of United Fuel's West Virginia customers sitting virtually on top of a gas well pay for their gas as though 80 per cent of it came from the Southwest. However, since United Fuel's gas supply from all sources is intermingled in such a way that it is impossible to tell who is served by what gas, the West Virginia Commission adopts the solution usually used for such purposes and pools all of the gas and allocates the cost of it on the basis of usage.

Of the great quantities of gas now being funneled through West Virginia, local customers consume only about 8 per cent. It is true that during peak periods this percentage climbs to about 12 per cent. Almost all of the remaining 92 per cent of the gas goes to United Fuel's interstate customers and mostly to Kentucky Gas Transmission Company, Ohio Fuel Gas Company, Manufacturers Light and Heat Company, and Atlantic Seaboard, affiliates of United Fuel.

Since United Fuel's costs are incurred to serve both interstate and intrastate customers, since its facilities are used to serve both interstate and intrastate customers, and since it is impossible, accurately, to segregate those costs and facilities between interstate service and intrastate service, it is necessary to allocate the costs. The West Virginia Commission considers that such allocation should be made on the basis of use. We understand that that is, in general, the method used

by the Federal Power Commission and other regulatory agencies.

It is commonly considered that costs in the gas business may be divided between those incurred for and associated with the procuring and delivery of annual volumes of gas (usually called "commodity costs") and those additional costs associated with meeting peak-period demands (called "demand or capacity costs"). Some costs fall neatly into one or the other category. Other costs have both elements in them. The latter costs, by what has come to be known as the "Atlantic Seaboard Formula," developed by the Federal Power Commission, are assigned (or "classified") 50 per cent to demand and 50 per cent to commodity. Both the West Virginia Commission and the Federal Power Commission follow, in general, the Atlantic Seaboard Formula in the classification and allocation of costs between jurisdictions. Commodity costs are allocated on the basis of annual sales while demand costs are allocated on usage during a three-day sustained peak period.

On May 1, 1962, Case No. 5536 was instituted before the Public Service Commission of West Virginia by the filing by United Fuel of a tariff stating increased rates and charges for its gas service in West Virginia. The tariff was suspended until October 2, 1962, and hearings were held on August 27 through August 30, 1962.

Of all the complex steps necessary in the classification and allocation of United Fuel's costs, only one resulted in substantial controversy at the hearing. The Commission's staff took the position that the costs

which United Fuel paid to Columbia Gulf for transporting gas from Louisiana should be classified 100 per cent to commodity. United Fuel insisted that the costs should be split about 50 per cent to demand and 50 per cent to commodity. After considering evidence that Columbia Gulf operated at 97 per cent of capacity during the test period and that during its peak day when it was operating at overload conditions it delivered only about 10 per cent more than it did on an average day, the Commission decided that these costs should be classified 100 per cent to commodity, the same as the purchase costs for the same gas in Louisiana, concededly a commodity cost.

At the hearings counsel and consultants for the protestant cities pointed out that under the new Guidelines Procedures promulgated by the Internal Revenue Service, United Fuel had available to it additional depreciation deductions which would decrease its tax liability. United Fuel declined to say whether or not it was going to use the new Guidelines Procedures in calculating its federal income tax. Pointing out that the company did not state any reason for not using them nor any way in which it might be adversely affected by using the new rates, the Commission decided to compute United Fuel's cost of service by considering the Guidelines rates in connection with the income tax allowance. By order entered on October 17, 1962, the Public Service Commission of West Virginia approved intrastate rates for United Fuel Gas Company designed to increase its revenues by $361,104.00.

After the entry of the Commission's final order and in the light of it, United Fuel, for the first time, said, in its petition for rehearing, that it did not plan to use

the depreciation rates provided for by the Guidelines Procedures. By order entered by the Commission on December 13, 1962, the Commission refused to reopen the proceeding.

Both United Fuel and the protestant cities petitioned the Supreme Court of Appeals of West Virginia to review and set aside the orders of the Public Service Commission, United Fuel because the rates were too low and the cities because the rates were too high. After the filing of briefs and the oral arguments of counsel, the Court denied both petitions. United Fuel Gas Company appeals to this Court from the order of the Supreme Court of Appeals of West Virginia denying its said petition.

II. No Conflict Between the Order of the West Virginia Commission and any Order of the Federal Power Commission Exists.

The inescapable inference which anyone not intimately acquainted with the facts would draw from United Fuel's jurisdictional statement filed with this Court is that the West Virginia Commission has decided that the Columbia Gulf costs should be classified 100 per cent to commodity and the Federal Power Commission has decided that they should be classified about 50 per cent to demand and 50 per cent to commodity. But that statement is simply not true. The truth is that the West Virginia Commission has decided to classify those costs 100 per cent to commodity, not once but three times, but that the Federal Power Commission had not decided the issue at all. Although United Fuel has constantly tried to becloud this issue before the Commission and before the Supreme Court

of Appeals and succeeded in leading Commissioner Townsend into the error mentioned on page 7 of the jurisdictional statement, the facts are clear and may be readily documented. United Fuel's knowledge of the facts readily appears from the record in this case itself. C. H. Workman, vice president of United Fuel and other Columbia companies, admitted on cross-examination that the Federal Power Commission had never decided this issue (Tr. p. 113).

All of United Fuel's rate cases before the Federal Power Commission in which gas transported by Gulf Interstate or Columbia Gulf has been involved have been settled rather than decided. These settlements were made at conferences of United Fuel, its customers, Federal Power Commission staff, and other intervenors, including the Public Service Commission of West Virginia. In each case the conferees agreed on a dollar cost of service without agreement on the principles underlying or supposed to underlie that cost of service.

In approving those settlements, the Federal Power Commission did not pass upon any issues or principles supposed to underlie the settlements. The FPC made this most strikingly clear in its order issued September 15, 1960, approving the settlement in Dockets Nos. G-12195, G-16316, G-16815 and G-18420 in which it said, "In issuing this order, the Commission's action is not to be construed as a concurrence with the cost of service determinations, allocation methods and rate design principles used in arriving at rates and charges for future sales, or in computing the amounts of refunds agreed upon in the settlement agreement, and neither the Commission, its staff, or the parties to the proceed-

ings are to be prejudiced or bound thereby in future proceedings." The Commission's order dated October 19, 1956, in Dockets Nos. G-2451 and G-5475 (16 FPC 1069) is to the same effect. The order entered in *United Fuel Gas Company*, Docket No. G-20270, on March 20, 1962, says, "This order is without prejudice to any findings or orders which have been or may be made hereafter by the Commission, and is without prejudice to claims or contentions which may be made by the Commission, United Fuel, the Commission's staff, or any affected party herein, in any proceeding now pending or hereafter instituted by or against United Fuel or any other companies, persons, or parties affected by this order."

It is in this context that United Fuel tells this Court that there has been a determination by the Federal Power Commission of the question of the proper classification of the costs which United Fuel pays to Columbia Gulf Transmission Company, resulting in a conflict between the Public Service Commission of West Virginia and the Federal Power Commission.

It is quite true that in preparing cost-of-service studies for settlement conference purposes in those rate cases the Federal Power Commission's staff classified the Columbia Gulf costs approximately 50 per cent to demand and 50 per cent to commodity. But, as pointed out above, the classification was neither litigated nor agreed. It should be apparent that the West Virginia Commission would not agree to one method of classification before the Federal Power Commission while adopting another for the same company in West Virginia.

Nor can it be demonstrated that the dollar gap of which United Fuel complains actually exists. First of all, the cost-of-service figures arrived at by using the fifty-fifty classification of Columbia Gulf costs was adjusted upward to arrive at the settlement figures, and, secondly, different test periods have always been used for the cases before the Federal Power Commission and those before the West Virginia Commission. Use of these different test periods has resulted in different allocation factors being applied by the different commissions. By coincidence or otherwise, adding the allocation factors for interstate business used in the Federal Power Commission case to the allocation factors for West Virginia business used in the closest West Virginia case and those allocation factors for business under the jurisdiction of neither commission, has usually resulted in more than a hundred per cent.

We, of course, cannot say how the Federal Power Commission will decide this issue in some future case. We feel sure that the FPC would decide it on the record before it, after giving due consideration to the conflicting views of all parties, including the West Virginia Commission. We cannot even say how the West Virginia Commission, in some future case, upon a different record, and perhaps with different commissioners, would decide the issue. We can only say that to this point there has been no conflict on this issue between any order of the West Virginia Commission and any order of the Federal Power Commission.

There has been a head-on collision on this question of classification between the West Virginia Commission and the United Fuel Gas Company, but such a conflict hardly presents a federal question proper for con-

sideration by this Court, nor does a difference of opinion between the West Virginia Commission and some members of the Federal Power Commission staff. These questions of cost allocation are questions of fact—not law. *Colorado Interstate Gas Co.* v. *Federal Power Comm.* (1945), 324 US 581, 65 Sup Ct 829.

III. The Commission's Decision on Federal Income Tax Allowance does not Conflict with any Federal Law.

United Fuel discusses the Commission's decision to compute the federal income tax allowance for United Fuel by using the additional depreciation deductions available to it under the Guidelines Procedures as though that decision were reached after United Fuel had stated that it was not going to use those Guidelines Procedures. The truth is that on the record in Case No. 5536 the company refused to say whether or not it would use such Guidelines depreciation rates and did not announce that it did not plan to use them until after the entry of the Commission's final order of October 17, 1962. In a petition for rehearing in connection with such order and in the light of that order, United Fuel, for the first time, announced that it did not plan to use the increased depreciation rates. The facts shown by the record were that the Guidelines depreciation rates were available to United Fuel and that United Fuel might or might not use them in preparing its income tax returns.

On this issue the company is asking this Court to do no less than to try this issue *de novo* on the basis of matters which were not presented in evidence and which have a status no higher than that of self-serving declarations.

The West Virginia Commission, on the other hand, insists that its decision on this issue should be treated by no other standard than the information properly available to it before the entry of the order complained of. The elements adduced at the hearing showed that there was available to United Fuel an income tax deduction for depreciation substantially in excess of that used in the test period as the result of new regulations by the Internal Revenue Service, commonly referred to as "Guidelines Procedures"; that those depreciation rates were available to the company without penalty for at least three years; that no way in which the company could be hurt within the foreseeable future by using those Procedures had been shown; and that the company, for good reasons or bad, took no position on whether or not it would use the Guidelines rates, saying that it would not know for several months, a period longer than the Commission could wait for the answer.

The Commission was thus faced with two alternatives: 1) It could use the depreciation rates available under the Guidelines Procedures and run the risk that the company would say it did not intend to use them, that the action of the Commission was arbitrary and capricious, and that its property was being confiscated —exactly what happened; or 2) it could ignore the availability of the additional depreciation deductions and run the risk that the company would use them and recover from the customers an allowance for income taxes never actually paid. In the first case, assuming that the decision of the Commission was not disturbed by the courts, the company would either have to use the Guidelines rates or accept the loss for not using them until it could, in a rate case, persuade the Commission to change its position, if in fact it could. If the

second alternative were followed, the consumers might have to pay rates sufficient to include these "phantom taxes" for whatever time the rates approved in this proceeding were in effect, without any recourse or remedy whatsoever. The two alternatives hardly seem comparable at all. In view of the additional fact that a utility is under a duty to keep the cost of its service to the public as low as it reasonably can, the Commission decided to resolve the doubt in favor of the public and to use the Guidelines rates.

Section 4, Article 2, Chapter 24 of the 1931 Code of West Virginia, as amended (Serial Section 2556), provides in part, "At any hearing involving a rate sought to be increased or involving the change of any fare, charge, classification, regulation or practice, the burden of proof to show that the increased rate or proposed increased rate, or the proposed change of fare, charge, classification, regulation or practice is just and reasonable shall be upon the public utility making application for such change." This burden of proof extends not only to the overall case but also to the constituent elements thereof. *Natural Gas Co.* v. *Public Service Comm.*, 95 W. Va. 557, 121 SE 716. This position is also supported by *Lindheimer* v. *Bell Telephone Co.* (1934), 292 US 151, 54 Sup Ct 658.

Certainly the burden is on a utility to prove the propriety of its claimed allowance for federal income tax as much as any other element of a rate case. Not only did the company fail to carry this burden, but it failed to take an unequivocal position on what it planned to do.

The West Virginia Commission did not deprive United Fuel of any of its rights under Section 167 of the Internal Revenue Code or under the Guidelines Procedures. Under those Procedures there was an election to be made which could change the federal income tax to be included in the cost of service by a substantial amount. United Fuel failed and refused to make that election during the time the Commission was considering the case. All that the Commission did in its final order was to make the election for United Fuel insofar and only insofar as the West Virginia rate case was concerned.

We feel that the West Virginia Commission's decision on this point was the only acceptable choice between the alternatives available to it on the record. Nor do we think that it would have been proper for the Commission to have reopened the proceeding and changed its decision on the depreciation question based on information submitted for the first time in the petition for rehearing. If a company were permitted to withhold information or refuse to take a position until after the Commission's order and then, in the light of that order, present the information or take the position and on that basis ask for a reconsideration of the order, there would be no end to the mischief that would result. At any rate, whether the Commission's decision was right or wrong, there is no conflict between it and the Internal Revenue laws or any regulations issued under them.

It is, therefore, submitted that there is no conflict between the order complained of and any order of the Federal Power Commission; that there has been no interference by the West Virginia Commission with

the flow of gas in interstate commerce; that the Commission's findings were not arbitrary but were based on evidence; that the utility has been given a fair hearing and has failed to carry the burden of proof and has failed to overcome the legal presumption of the validity and correctness of the order herein involved, and this being true, has failed to show the existence of a substantial federal question.

Appellee, Public Service Commission of West Virginia, contends that the record in this case discloses no substantial federal question and, therefore, this Court is without jurisdiction of this cause. It is, therefore, submitted that appellee's motion herein to dismiss the appeal or affirm the judgment of the Supreme Court of Appeals of West Virginia should be granted. Wherefore appellee prays that this Court refuse to note jurisdiction of this cause and that appellee's motion to dismiss the appeal or affirm the judgment be granted.

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January 15, 1964